

Katalyst Kaleidoscope

July 2019: The Union Budget 2019-20

A. Background and Macro factors

Introduction

With the Modi 2.0 government coming into power with an overwhelming majority, the nation expected a pro-growth budget to put India on a fast track mode, provide stimulus to slow economy and stressed sectors, accelerate job creation while maintaining the fiscal balance.

In this context, India's first full-time lady Finance Minister presented her maiden budget in Lok Sabha on Friday, 5th July 2019. The Budget lays down the blue print to become the USD 5tn economy. It aims to boost infrastructure and investment against the backdrop of a slowing economy, weak consumption demand, rural distress, high unemployment and lack of private investment. An attempt has been made to maintain overall balance; however, on ground execution will be critical.

Macro-economic backdrop

- Indian economy will grow to become a USD 3tn economy in the current financial year. It is now 6th largest in the world.
- India's FDI inflows in 2018-19 remained strong at US\$ 64.375 billion, marking a 6% growth over the previous year.
- The GDP grew by 6.8% in FY19, which is the lowest growth rate in the last 5 years. GDP growth for Q4 for FY19 has dropped to 5.8%, which is significantly lower than the growth witnessed during the first 3 quarters. The Economic Survey FY19 has projected that the economy will grow at 7% in FY20.

- Budget 2019 at a glance:

(INR in crs)

	2017-2018 Actuals	2018-2019 Budget Estimates	2018-2019 Revised Estimates	2019-2020 Budget Estimates
1. Revenue Receipts	14,35,233	17,25,738	17,29,682	19,62,761
2. Tax Revenue (Net to Centre)	12,42,488	14,80,649	14,84,406	16,49,582
3. Non Tax Revenue	1,92,745	2,45,089	2,45,276	3,13,179
4. Capital Receipts	7,06,740	7,16,475	7,27,553	8,23,588
5. Total Receipts	21,41,973	24,42,213	24,57,235	27,86,349
6. Total Expenditure	21,41,973	24,42,213	24,57,235	27,86,349
7. On Revenue Account	18,78,833	21,41,772	21,40,612	24,47,780
8. On Capital Account	2,63,140	3,00,441	3,16,623	3,38,569
9. Revenue Deficit	443600	416034	410930	485019
%	(2.6)	(2.2)	(2.2)	(2.3)
10. Fiscal Deficit	591062	624276	634398	703760
%	(3.5)	(3.3)	(3.4)	(3.3)

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- Fiscal deficit is expected to be 3.4% of GDP in FY19 and 3.3% in FY20, higher than the 3.3% and 3.1% envisaged for FY19 and FY20, respectively, in the 2018-19 Budget. The Government has projected to adhere to the Fiscal Responsibility and Budget Management Act, 2003's target of 3% in 2020-21, which seems to be challenging now.
- Total receipts (net) of the Central Government are expected to be INR 27.4tn in FY20, which is 13.2% higher than FY19 Revenue Expenditure. Receipts from disinvestment have been budgeted at INR 1.05tn for FY20.
- Total expenditure of the Central Government is expected to be INR 27.9tn in FY20, which is 13.4% higher than in FY19.
- As per the 2019-20 Budget, Central Government debt (excluding extra budgetary resources) is expected to be 48.4% of GDP in 2018-19, which is lower than the 48.8% projected in the 2018-19 Budget.
- Central Government debt (excluding EBR) is projected to reduce to 47.3% of GDP in 2019-20 and further to 45.4% and 43.5% in 2020-21 and 2021-22, respectively. As per the amended FRBM Act, the Government will limit Central Government debt to 40% of GDP by FY 2025.
- The CPI inflation has been volatile throughout FY19, with the average rate of approx. 3.4% as against 3.6% in FY18.

B. Proposals by the Finance Bill (No.2), 2019

Key Regulatory Proposals:

Securities law

- SEBI to consider increasing minimum public shareholding in listed companies from current threshold of 25% to 35%
- Setting up social stock exchange under the purview of SEBI for listing of social enterprises and voluntary organisations to raise capital as equity, debt or units like mutual fund
- Rationalize and streamline the existing KYC norms for FPIs

Katalyst comments:

Increasing minimum public shareholding in listed companies to 35% is a controversial move. There are around ~1400 listed companies where promoters are holding over 65% stake. Thus, appropriate mechanism needs to be introduced (such as mode of implementation, timing, etc.) in order to implement such transition and avoid any adverse impact on capital markets. Such transition is anyway likely to take 2-3 years and applicability of such requirement to situations such as those for MNCs and PSUs needs to be factored in.

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Foreign Direct Investment ('FDI')

- FDI in aviation, media (animation, AVGC) and insurance sector may be further liberalised in consultation with all stakeholders;
- 100% FDI to be permitted for insurance intermediaries such as brokers, corporate agents, third party administrators;
- Local sourcing norms for FDI in Single Brand Retail sector to be eased.

Foreign Portfolio Investment ('FPI')

- Proposes to increase the statutory limit for FPI investment in a company from 24% to their respective sectoral FDI limit, with option given to the concerned corporates to limit it to a lower threshold;
- Merge NRI-Portfolio Investment Scheme Route with the FPI Route, thereby significantly liberalising NRI-Portfolio Investment Scheme;
- FPIs to be permitted to invest in listed debt securities of Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts ('InvITs').

Katalyst comments:

FDI as well as FPI liberalization is a welcome move will certainly make India a more attractive investment destination. However, FPI liberalization may also increase volatility in the capital market and on the currency front. Further, merger of NRI-Portfolio Investment Scheme Route with the FPI Route will enable NRIs to play a critical role in the capital markets.

Banking / Non-banking Financial Companies ('NBFC') / Housing Finance Companies:

- Regulatory authority over the housing finance sector to be shifted from NHB to RBI;
- Requirement of Debenture Redemption Reserve for public issues of debt by NBFCs to be removed;
- RBI to have more powers to govern NBFCs such as empowering RBI to (i) Remove directors of NBFCs in public interest; (ii) Remove or debar auditor from acting as auditor of any RBI regulated entities for a maximum period of 3 years; (iii) Frame schemes for the functioning of the financial system which may involve amalgamation or reconstruction or splitting of NBFC
- In order to facilitate on-shoring of international insurance transactions and enable opening of branches by foreign reinsurers in the International Financial Services Centre, it is proposed to reduce Net Owned Fund requirement from INR 5,000 crs to INR 1,000 crs
- For purchase of high-rated pooled assets of financially sound NBFCs (amounting to a total of INR 100,000 crs during FY 2019-20), Government will provide one time 6 months' partial credit guarantee to Public Sector Banks for first loss up to 10%;
- All NBFCs to be allowed to directly participate on the TReDS platform.

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Tax proposals

1. Corporate tax of 25% for domestic companies having turnover up to INR 400 crs in FY 2017-18:

- In continuation to phased reduction in corporate tax rates, benefit of lower tax rate of ~29% (inclusive of surcharge and cess) for FY 2019-20 has been extended to domestic companies having annual turnover or gross receipts upto INR 400 crs in FY 2017-18. The Finance Minister mentioned in her budget speech that ~99.3% of the companies will get benefit of such lower tax rate.
- There has been no reduction in the tax rates for LLPs/ firms from the current rate of ~35% (inclusive of surcharge and cess).

Katalyst comments:

- 1) *Though Finance Minister in her budget speech mentioned that only ~0.7% of the companies are left out of the lower corporate tax rate, it is pertinent to note that such ~0.7% companies account for the maximum tax collection.*
- 2) *The threshold refers to the turnover / gross receipts in FY 2017-18 and hence, even if turnover of any domestic company exceeds INR 400 crs in FY 2018-19 or FY 2019-20, such companies would be able to avail benefit of lower corporate tax rate.*
- 3) *Notwithstanding this amendment, a newly set up (i.e. on or after March 1, 2016) domestic company engaged in the business of manufacture or production of any article or thing (and research in relation to, or distribution of, such article or thing manufactured or produced by it), shall continue to enjoy lower corporate tax rate of 25% u/s 115BA of the IT Act, irrespective of its quantum of turnover / gross receipts.*

2. Increase in levy of Surcharge on Individuals in higher income brackets:

- As against existing surcharge of 15%, it has been proposed to hike the surcharge for Individuals / Hindu undivided families etc having a total income exceeding INR 2 crs but not exceeding INR 5 crs to 25%, and for total income exceeding INR 5 crs to 37%.

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- Such increase in Surcharge shall impact the effective tax rate as under:

Particulars	Surcharge	% Indicative tax rate for FY20 (FY19)
Income up to INR 50 lakhs	None	31.2 (31.2)
Income above INR 50 lakhs upto INR 1 cr	10%	34.32 (34.32)
Income above INR 1 cr upto INR 2 cr	15%	35.88 (35.88)
Income above INR 2 cr upto INR 5 cr	25%	39.00 (35.88)
Income above INR 5 cr	37%	42.74 (35.88)

3. Levy of Buyback Tax ('BBT') @23.3% made applicable to Listed Companies:

- In order to curb tax arbitrage available to Listed Companies through buyback of shares as against dividend distribution [which is subject to Dividend Distribution Tax ('DDT')], it is proposed to extend levy of BBT to Listed Companies. Thus, any buy back of shares from a shareholder by Listed Companies on or after 5th July 2019 shall be subject to BBT @23.3%.
- It is also proposed to extend exemption u/s 10(34A) (which exempts the consequential income arising in the hands of shareholders pursuant to buyback) to the shareholders of the Listed Companies.

Katalyst comments:

- 1) *Recently several companies especially high payout companies (such as Wipro, L&T, Tech Mahindra, HCL Technologies, etc.) had resorted to buyback route, rather than dividend payout which, apart from being tax efficient, also improves earning per share of the Company (since the equity capital base reduces).*
- 2) *With proposed levy of BBT on Listed Companies, there is likely to be reduction in number of Listed Company buybacks. However, from an individual shareholders perspective, buyback route may still be better than dividend route, since dividend income is also taxed in the hands of recipient shareholders (other than domestic companies, etc.) at the rate of 10% (plus surcharge and cess), whereas amount distributed upon buyback is specifically tax exempt for the recipient.*
- 3) *Separately, similar to DDT, in case of non-resident shareholders, credit of BBT under the Double Taxation Avoidance Agreement ('DTAA') is not available; and capital gains arising upon buyback may be taxed in the home country of non-resident shareholders.*

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4. Relief for failure to deduct tax while making payment non-resident person:

- Presently the deductor / payer is not deemed as an 'assessee in default' if he fails to deduct tax on a payment made to a resident, if such resident has furnished his return of income u/s 139, disclosed such payment for computing his income in his return of income, paid the tax due on the income declared by him in his return of income and furnished an CA certificate to this effect. However, such relief was not available to the deductor / payer on payment made to a non-resident.
- In order to remove this anomaly, it is proposed to extend the above benefit to payments made to non-residents as well.
- Additionally, it also proposed that there will be no disallowance in the hands of payer / deductor in respect of such payments to non-residents.

Katalyst comments:

Such relief will certainly help in M&A transaction negotiations (such as indemnity, etc.) involving non-residents sellers (especially Mauritius / Singapore sellers intending to claim grandfathering under the respective DTAAs).

5. No requirement to record the property and liabilities at book value in case of Demerger of Ind-AS compliant companies:

- Requirement of recording property and liabilities at book value by the resulting company shall not be applicable in a case where the property and liabilities of the undertakings received by it are recorded at a value different from the value appearing in the books of account of the demerged company immediately before the demerger, in compliance with Ind-AS.

Katalyst comments:

This amendment resolves the disconnect under the IT Act and Ind-AS and certainly addresses a roadblock in M&A transactions by way of demergers. This amendment is beneficial from the perspective of demerged as well as resulting company and will take effect from FY 2019-20.

6. Tax incentives for affordable housing:

- Definition of 'affordable housing' for the purpose of profit linked deductions available to housing developer's u/s 80-IBA has been aligned with the definition under GST Act. Developers shall be eligible for deduction, in respect of a housing project, if (i) a residential unit in the housing project have carpet area not exceeding 60 square meter in metropolitan cities or 90 square meter in cities or towns other than metropolitan cities; and (ii) the stamp duty value of such residential unit in the housing project shall not exceed INR 45 lakhs.

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- **Interest deduction:** It is proposed to insert a new section 80EEA in the Act so as to provide a deduction in respect of interest up to INR 1.5 lakhs on loan taken for residential house property from any financial institution subject to the conditions that (i) loan has been sanctioned during the period beginning on the 1st April 2019 to 31st March 2020; (ii) the stamp duty value of house property does not exceed INR 45 lakhs; (iii) tax payer does not own any residential house property on the date of sanction of loan.

7. Rationalisation for Non-banking Financial Companies ('NBFCs'):

- Presently, interest income on bad or doubtful debts made by NBFCs is charged to tax on accrual basis. However, in cases of scheduled banks, public financial institutions, certain public companies like housing finance companies, etc. interest on bad or doubtful debts is charged to tax on receipt basis. To provide a level playing field, it is proposed that interest on bad or doubtful debts in the case of deposit-taking NBFC and systemically important non deposit-taking NBFC shall be charged to tax on receipt basis. It is also proposed that deduction of such interest shall be allowed to the payer upon actual payment.

8. Incentives for start-ups:

Section 79 Amendment	Condition for carry forward and set off of business losses:	
	Prior to Finance Bill, 2019	Post Finance Bill, 2019
Other than Eligible Start-ups ("Others")	Clause (a): 51% of the voting power shall be beneficially held by the same persons who held such voting rights in the year in which the losses were incurred	No Change
Eligible Start-ups ("Start-up")	Clause (b): i) All shareholders of the Start-up who held shares on the last day of the year in which losses were incurred, shall continue to hold the shares in Start-up on the last day of the year; AND ii) such losses have been incurred during the period of 7 years beginning from beginning from the year in which Start-up is incorporated	Loss allowed to be carried forward even where shareholders continue to beneficially hold 51% voting power. i.e. option has been provided to either satisfy the existing conditions under Clause (b) OR Clause (a), which was earlier applicable only to 'Others'.
Example	<i>Under the erstwhile provisions, if the Start-up has 2 shareholders, say A and B, holding 60% and 40% respectively, and if B were to exit his 40% stake, then even if the overall shareholding at Start-up level does not</i>	

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change by more than 51% (since A continues to hold 60%), exit of B would result in lapse of business losses for such Start-up.

Under the proposed amendment, upon exit of such shareholder, the losses shall be available to be carried forward, provided the overall shareholding of the Start-up does not change by more than 51% (i.e. in the above example, if B sells his 40% stake in the Start-up, since A continues in the Start-up as a 60% shareholder, losses of Start-up would be available to be carried forward)

- **Capital gains exemption for investment in Start-ups:** Exemption of long-term capital gains from sale of residential property upon investment of net consideration in equity shares of eligible start-up shall be extended up to 31st March 2021. Further, the condition of minimum holding of 50% of share capital or voting rights in the start-up is proposed to be relaxed to 25%. The condition restricting transfer of new asset being computer or computer software purchased by the start-up is also proposed to be relaxed from the current 5 years to 3 years.
- **Non-applicability of Angel tax to Category II AIF:** Investment in venture capital undertaking by SEBI registered Category II Alternative Investment Funds (AIF) is proposed to be exempted from the applicability share premium taxation u/s 56(2)(viib).
- Start-ups and their investors who file requisite declarations and provide information in their returns will not be subject to any kind of scrutiny in respect of valuations of share premiums. In respect of pending assessments, no inquiry or verification will be done without obtaining supervisory approval.

Katalyst comments:

Attempt has been made to provide relief to start-ups against Angel tax implications. However, outlier provisions of section 56(2)(viib) should not be applicable in genuine case of funding and further carve-outs (such as funding in 100% WOS by the parent company, etc.) should have been provided.

9. Incentives to International Financial Services Centre ('IFSC'):

- 100% profit linked deduction in any 10 year block within a 15 year period to a unit in IFSC.
- Capital gains exemption for any transfer by a Category III AIF (all the unit holders being non-residents) in IFSC of a specified capital asset being Global Deposit Receipts, rupee denominated bonds of an Indian company, derivative or such other securities as may be notified by Central Government, subject to specified conditions
- Any income by way of interest payable to a non-resident by a unit located in IFSC in respect of monies borrowed by it on or after 1st September, 2019, shall be exempt.

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- Exemption from DDT from current and accumulated income to companies and mutual funds located in IFSC.
- It is further proposed to amend section 115A (4) (prohibiting any deduction under chapter VIA including section 80LA while computing tax payable of a non-resident or foreign company) so as to provide that the conditions contained in sub-section (4) of section 115A shall not apply to a unit of an IFSC claiming deduction under section 80LA, in order to ensure that units located in IFSC claim full deduction.

10. Pass through of losses between Category I AIF and Category II AIF and their unit holders:

- Presently, pass through of losses not provided and are retained at AIF level. It is proposed to rationalise the provisions relating to carry forward and setoff of loss between Category I AIF and Category II AIF and their unit holders and provide that (i) business loss of the investment fund to be retained at AIF level and shall not be passed onto the unit holder; (ii) loss other than business loss, if any, shall also be ignored for the purposes of pass through to its unit holders, if such loss has arisen in respect of a unit which has not been held by the unit holder for a period of at least 12 months; (iii) loss other than business loss, if any, accumulated at the level of investment fund as on 31st March, 2019, shall be deemed to be the loss of a unit holder who held the unit on 31st March, 2019 in respect of the investments made by him in the investment fund and allowed to be carried forward by him for the remaining period calculated from the year in which the loss had occurred for the first time taking that year as the first year.

11. Relaxation in conditions of special taxation regime for offshore funds

- The cut-off date for determining monthly average of corpus of fund (i.e., INR 100 crs) would be either (A) six months from end of month of its establishment or (B) at the end of such financial year, whichever is later.
- The remuneration paid by fund to an eligible fund manager would not be less than the amount calculated in the prescribed manner replacing the requirement to have arm's length remuneration.

12. Faceless assessment

With an intent to eliminate undesirable practises of tax officers, a centralised faceless electronic scrutiny assessment would be launched in a phased manner.

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13. Other changes:

Substantive changes

- The scope of “income deemed to accrue or arise” in India in case of non-residents will be expanded to include “any gift of money or property situated in India by resident to Non-resident.” However, existing exemptions under the income tax law and tax treaty benefits will continue to apply.
- It is proposed to amend section 56(2)(x) and section 50CA to empower the CBDT to prescribe transactions undertaken by certain class of persons to which such provisions shall not be applicable.
- Deduction up to INR1.5 lakh introduced for interest paid on loan taken to purchase an electric vehicle during the period from 1st April 2019 to 31st March 2013.
- In line with press release dated 17th September 2018, it is proposed to incorporate exemption provided to interest income payable to a non-resident by an Indian company or a business trust in respect of monies borrowed from a source outside India by way of issue of rupee denominated bond during the period beginning from 17th September 2018 and ending on 31st March 2019. Consequently, no tax is required to be deducted on the payment of interest in respect of such bonds.
- Levy of TDS at the rate of 2% on cash withdrawal in excess of INR 1 cr in aggregate made during the year from the bank / post office account.
- In order to further incentivize fund of funds set up for disinvestment of Central Public Sector Enterprises (CPSEs), it is proposed to amend Section 111A so as to extend the concessional rate of tax (15%) for short-term capital gains in respect of transfer of units of such fund of funds.
- In order to rationalise the levy of STT where the option is exercised, it is proposed to amend Sec 99 of the Finance (No 2) Act, 2004 so as to provide that value of taxable securities transaction in respect of sale of an option in securities, where option is exercised, shall be the difference between the strike price and the settlement price.

Procedural changes

- TDS at the rate of 5% to be applied on contractual work or professional fees payments (for the purpose of business or profession) made by an individual/HUF (not required to withhold u/s 194-C and 194-J) where annual aggregate of payments exceeds INR 50 lakhs in a year. Further, such individuals or HUFs shall be able to deposit the tax deducted using

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their Permanent Account Number (PAN) and shall not be required to obtain Tax deduction Account Number (TAN).

- For ease of taxpayers, PAN and Aadhaar will be made interchangeable, and taxpayers without PAN can file the tax returns quoting Aadhaar. Further, every person who has been allotted a PAN, and who has linked his Aadhaar number under section 139AA, may furnish or intimate or quote his Aadhaar number in lieu of a PAN.

Indirect Tax Provisions:

Central Excise and Service Tax:

With effect from 6th July 2019, it is proposed to increase the excise duty on following items:

- Increase in the rate of basic Excise duty of Petroleum Crude from NIL to Rs. 1 per tonne
- Increase in Special Additional Excise Duty on petrol from Rs.7 to Rs.8 per litre and on diesel from Re. 1 to Rs.2 per litre respectively.
- Increase in Road and Infrastructure Cess on both petrol and diesel from Rs.8 to Rs.9 per litre.

Sabka Vishwas (Legacy Dispute Resolution) Scheme, 2019

In order to close the long pending litigations involving an amount of INR 3.73 lakhs crs, in Excise and Service tax, the Sabka Vishwas (Legacy Dispute Resolution) Scheme, 2019 has been introduced. The proposed scheme provides relief in the following ways:

- Relief from 40–70 percent of tax dues, and waiver of interest and penalty for cases other than voluntary disclosure ones.
- Waiver of interest and penalty on payment of full tax dues disclosed for voluntary disclosure cases.
- No prosecution for the person discharged under the scheme.
- Amount paid under Scheme is shall not be paid through ITC or taken as ITC.

Customs:

- The brief snapshot of amendments in customs duty rates are as under:

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Sr. No	Particulars	From	To
1.	Specified Defence equipment and their parts imported by the Ministry of Defence or the Armed Forces	Applicable rates	NIL
2.	Parts of electrical vehicles such as E-Drive assembly, on board charger, E-compressor and Charging Gun	Applicable rates	NIL
3.	Petroleum crude	NIL	Re. 1 per tonne

Goods and Service Tax:

Constitution of National Appellate Authority for Advance Ruling ('NAAAR')

- The definition of 'adjudicating authority' amended to exclude the NAAAR.
- Appeal to NAAAR may be preferred in cases where conflicting advance rulings by Appellate Authorities of two or more States or UTs, by any officer or applicant aggrieved by advance ruling and in respect of questions referred in section 97(2) of the CGST Act.
- Time period for filing the appeal is 30 days from communication of ruling sought to be appealed against.
- NAAAR shall pass the order within 90 days from the date of filing of the appeal.

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